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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 448

PETROLEUM EXPLORATION, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 29–33) is reported in 23 B. T. A. 890. The opinion of the Circuit Court of Appeals (R. 42) is reported in 61 F. (2d) 273.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered October 8, 1932. (R. 51.) The petition for a writ of certiorari was filed October 12, 1932, and was granted November 14, 1932. The

jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under the Revenue Act of 1926, capitalized expenditures for drilling oil wells and for hauling and placing equipment may be added to the cost of physical property subject to a depreciation allowance or are returnable to the taxpayer through a depletion allowance.

STATUTES AND REGULATIONS INVOLVED

These will be found in Appendix A of petitioner's brief in No. 434, *United States* v. *Dakota-Montana Oil Co.*

STATEMENT

The facts as found by the Board of Tax Appeals, upon a stipulation, are in substance as follows:

Petitioner is a Maine corporation with its principal office at Sistersville, West Virginia. (R. 30.) On December 31, 1924, its undepreciated investment in equipment in oil wells amounted to $475,975.02. (R. 31.) The taxes involved are those for the years 1925, 1926, and 1927. (R. 30.)[1]

During 1925, 1926, and 1927 petitioner capitalized on its books the total cost of new productive oil wells drilled, such charges representing amounts paid for equipment put into the wells, amounts paid to drilling contractors for drilling the wells,

[1] The Revenue Act of 1926 applies to the year 1925, § 286.

amounts paid for freight and haulage of the equipment, and amounts paid for labor in installing the equipment in the wells, as set out in tabular statement on page 31 of the record. The productive life of these wells is greater than one year. (R. 31.)

Depreciation was claimed by petitioner and allowed by the Commissioner at the unit production rate, based on the life of the oil deposits. (R. 31.)

The Commissioner, in making his computation of depreciation, added to the depreciation schedules the cost of equipment added each year, but did not add the cost of drilling wells, hauling and placing the equipment. (R. 31.) He added the cost of drilling wells, hauling and placing the equipment to the cost-depletion schedules; but depletion has been allowed on a statutory percentage basis (27½ per cent of gross income, not to exceed 50 per cent of net income), and is not based on cost. (R. 31.)

Petitioner, in making its computation of depreciation, added the total cost of completed wells, including equipment, drilling, hauling and placing the equipment, to its depreciation schedules, no part of the cost of the wells being added to the cost-depletion schedules. The amounts of increase in the depreciation allowances and of decrease in depletion allowance, if petitioner's method of determining the allowances be adopted, are shown on record page 32.

The Board sustained petitioner's contention that it was entitled to add to its property subject to de-

preciation the cost of drilling, hauling and placing equipment and thus to receive a depreciation allowance thereon, and redetermined the amount of the deficiencies accordingly. (R. 33.) The Circuit Court of Appeals reversed the Board.

ARGUMENT

This case involves the right of the petitioner under Section 234 (a) (8) of the Revenue Act of 1926, and Regulations 69, Articles 223 and 225 thereunder, to treat capitalized costs of drilling oil wells, hauling and placing equipment as property upon which a depreciation allowance may be made in addition to the arbitrary depletion allowance under Section 204 (c) (2) of the Revenue Act of 1926. The question thus presented is in all respects similar to the question presented in No. 434, *United States* v. *Dakota-Montana Oil Co.*, except that in the instant case the expenses which the petitioner seeks to have returned through depreciation include expenses for hauling and placing equipment but do not include expenditures for preliminary development. It has been assumed throughout this case that the expenses for hauling and placing equipment were expenses in connection with the hauling and placing of drilling equipment, and hence the expense was a part of the cost of drilling the wells. Accordingly, the proper treatment of these expenses depends upon the same considerations which are dealt with in Point I of the petitioner's brief in No. 434. As the matter has

been fully discussed therein, we respectfully refer to our argument in Point I of that brief as our argument in this case.

CONCLUSION

The decision of the court below was correct and should be affirmed.

Respectfully submitted.

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